

RESPONSE OF SIR ADRIAN CADBURY

I have two general points relating to your Review. The first you address directly in A.1 and that is the role of the chairman. The effectiveness of non-executive directors depends to a great extent on the way in which their chairmen make use of their abilities and experience. Chairmen would also expect to play a leading part in their selection and so have a further influence on their effectiveness as members of the board team. One needs to start with the influence of the role of chairmen before being able to move on to the effectiveness of non-executive directors, as such.

My second point is probably a waste of time and can be ignored. It is simply that there would be advantages in getting rid of the title "non-executive director". It does not explain their role, it describes what they are not and it does nothing to further their reputation. It is widely misunderstood as implying that they differ from and carry less responsibility than executive directors. I attach for illustration two pages from an article written by Ira Millstein which brings out the advantages of using the term "outside director". It explains what they are and it conveys their role, that of bringing an external judgement to board issues. It enables the differentiation between those who are independent and those who are not to be easily made and it allows reference to be made to executive sessions of outside directors. As I say, this may be tilting at a windmill, in which case ignore it.

With best wishes,

Yours sincerely
Adrian Cadbury.

mechanisms accordingly. While certain new board duties have been prompted by laws like the Foreign Corrupt Practices Act, the essential changes have been voluntary.²²

The principal corporate response was to increase the numbers and functions of outside directors, that is, directors who are not managers of or otherwise closely related to the corporation. Today, as a result, more than half the members of the typical board of the large corporation are outsiders.²³ The number of corporations with nominating committees responsible for selecting directors has increased from 9.2 percent in 1976 to 89.9 percent in 1986. Over 99 percent of these companies have audit committees, and, in our experience, these committees spend far more time at their work, paying attention to a larger range of issues in much greater detail than they would have ten or fifteen years ago.²⁴

With outside directors came not only more attention and diligence, but an awareness of the need to respond to greater social expectations. During the sixties and seventies, corporations were lectured and written to about the need to consider the effect their actions have on society, in terms of specifics such as product (or service) pricing, quality, and advertising; fair treatment of employees; health and safety in the workplace; plant openings and closings; the environment; community impact; philanthropy; and the welfare of suppliers and customers.²⁵ Perhaps grudgingly and under pressure, the corporation assimilated the concepts of "accountability" and "responsibility," again without the need for special legislation. As a credo, subsequently endorsed by the American Law Institute, the Business Roundtable in 1981 urged:

While it would be neither sensible nor possible to direct the full thrust of the corporate community efforts to curing all the nation's social ills, it is important that each corporation give attention to all of the consequences of its activities. Business enterprises are not designed to be either political or cultural institutions, but the business community will be well served by a habit of mind that stays alert to social currents. . . . A corporation's responsibilities include how the whole business is conducted every day. It must be a thoughtful institution which rises above the bottom line to consider the impact of its actions on all, from shareholders to the society at large. Its business activities must make social sense just as its social activities must make business sense.²⁶

In a few short years, in response to a host of internal and external changes, the purpose of the self-perpetuating corporation was subtly but importantly modified. Under these new circumstances, the outside director is faced with a great variety of responsibilities—the traditional one of overseeing management and guarding shareholder interests and the newer ones of "social responsibility" and "accountability" to nonshareholder constituents. Moreover, boards rely increasingly on outside directors when they may need to demonstrate that their decisions are independent of management interest. (Examples are nominating, audit, compensation, and special board committees.) And, most prominently, courts give the

discretion and business judgment of outside directors significant weight in decisions relating to contests for corporate control.²⁷

With this increased responsibility has come the fear of increased liability. But the courts have been remarkably generous in not holding directors liable to the corporation for their normal run-of-the-mill business decisions.²⁸ Indeed, Delaware and a number of other states have recently made it clear through statutory amendments that a corporate charter may provide that directors will not be liable for monetary damages for decisionmaking relating to the running of the business, as long as their decisions are free of dishonesty or self-aggrandizement and the decisionmaking process is pursued in good faith.²⁹

The outside director is, then, an important, relatively new corporate actor, with great freedom to act and even to make mistakes, as long as the actions are undertaken with care, loyalty, and respect for the corporation's obligations to its shareholders.

THE NEW CONTEXT FOR CORPORATE DECISIONS

Today, American corporations and, by implication, their boards of directors, face a new challenge: the task of sustaining or restoring (as the individual case may be) American competitiveness in what we all recognize—at last—as a fiercely competitive global economy. But they also have more freedom and flexibility (and perhaps even credibility) to meet this challenge than they could possibly have imagined a few short years ago. A variety of forces, some intellectual and philosophical, others more political and practical, have left the market system more unfettered by various kinds of public restraint than in a very long time indeed.

An example is the movement toward deregulation, whether manifesting itself in explicit policies—as in the case of the airline industry—or less explicitly in a relaxation of regulatory standards or in funding cuts for regulatory agencies, or in a growing, generalized suspicion of traditional “command and control” types of government interventions.

The government's attitude toward antitrust is another case in point. Today, mergers, joint ventures, and restructurings, even industrywide ventures, are limited only by the imaginations of the parties involved. Since the Reagan administration took office, very few mergers and no joint ventures that we know of have reached the courts because of government protest; instead, they are handled through administrative review by market-oriented federal agency appointees. Delineating interpretations of the law for mergers and joint ventures, the Justice Department's merger guidelines and other official statements of policy reflect a new kind of economic thinking: Big is not necessarily bad; barriers to entry and efficiencies are important factors to consider; worldwide competition,